مؤسسة النقد العربي السعودي
Saudi Arabian Monetary Agency

Value Added Tax:

Its Implementation and Implications

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Quarterly Workshops, 2016

Introduction

VA = value of output - value of inputs

- VAT is a multi point sales tax with set off for tax paid on purchases. It is basically a tax on the value addition on the product. Some economists call it a ***tax on consumption.***
- In many aspects it is equivalent to last point sales tax.
- It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services.
- It is not a charge on companies. It is charged as a percentage of price of goods or services.
- Introduction of a VAT will be one measure to strengthen the indirect tax structure.
- Added value is the value of what the producer has added to the inputs before they are sold as new products and services.

Source: IMF & European Commission, 2015

Taxes Classification and Recording

Based on Government Finance Statistics Methodology

Classified according to tax base:

11 Taxes

- **111** Taxes on income, profits, and capital gains
- **112** Taxes on payroll and workforce
- **113** Taxes on property
- **114** Taxes on goods and services
- **115** Taxes on international trade and transactions
- **116** Other taxes

1141	General taxes on goods and services
11411	Value-added taxes
11412	Sales taxes
11413	Turnover and other general taxes on goods and services
11414	Taxes on financial and capital transactions
1142	Excises
1143	Profits of fiscal monopolies
	(…)

Source: IMF, 2015

Global Facts

- The VAT is a feature of tax systems in over 150 countries.
- The VAT is an ideal revenue instrument for the GCC (for div. purpose).
- VAT accounts for a large share of tax revenue.
- Typical rates are set up between 5% to 25%.
- Global average VAT Rate is 12%.
- The average rate in Africa (low income countries) is 15.5%.
- Global average generation of revenue from VAT as share of GDP is 7.5%.
- According to the IMF estimates, the potential revenue from the implementation of 5 percent VAT is almost 1.6 percent of GDP for GCC countries.

Source: IMF, 2015

VAT Terminology

***Output VAT*:** Amount received by a seller as a percentage of the gross sale price of goods or services

Input VAT **:** Amount paid by a buyer as a percentage of the gross purchase price for goods or services used in production.

Zero Rated **:** Transactions in which the seller collects no output tax and the corresponding input tax is fully refundable.

Exports are zero rated.

Exempt **:** Transactions in which the seller collects no output tax but the corresponding input tax is non-refundable and absorbed by the seller.

Financial services are commonly exempt.

Most countries exempt food from the VAT.

Source: IMF & WB, 2015

Zero-Rating & Exemptions

- Exemptions at the zero rate apply only to medical, cultural and educational goods and services, and financial and insurance services.
- Daily necessities.
- Bread and milk, books, scientific journals, medical supplies.
- Transactions relating to the exported goods and the services provided in foreign countries.

Source: IMF & WB, 2015

How Does VAT Work?

- A trader registered for VAT effectively pays VAT only at one stage when he sells his goods.
- This tax is the only amount has an effect on his selling price which includes VAT.
- The VAT that he has paid as a part of his purchase price is charged on him by his suppliers.
- This is not a cost to him because he gets it back by deducting it from tax on his sales (Output Tax).
- Therefore, VAT should have a minimum impact on his selling prices.

Source: IMF & WB, 2015

Challenges in the Implementation of VAT

- Billing System
- Skilled staffing
- Lack of technology systems
- Lack of infrastructure facilities
- Unavailable tax law/act & regulations
- Provision of Points of Sale

Source: IMF, 2015

Issuing Tax Bills and Invoices

- According to the global standard VAT ACT, you ***CANNOT*** sell any goods without a sales document.

- The prices mentioned on these sale documents should include VAT and the words "*Price includes VAT*" must be printed on them.

- The original invoice must be handed to the customer and seller keeps a duplicate.

- For selling on credit, you are required to provide the purchaser with a tax invoice at the time of supply in respect of that supply.

- All tax invoices should be serially numbered and issued in serial number order.

Source: IMF, 2015

Advantages of VAT

1. As compared to other taxes, there is a less chance of tax evasion. VAT minimizes tax evasion due to its catch-up effect.

2. VAT is simple to administer as compared to other indirect tax.

3. VAT is transparent and has minimum burden to consumers as it is collected in small fragments at various stages of production and distribution.

4. VAT is based on value added not on total price. So, price does not increase as a result of VAT.

5. There is mass participation of taxpayers --- EQUALITY.

Source: IMF, 2015

Disadvantages of VAT

1. VAT is costly to implement as it is based on full billing system.

2. VAT is relatively complex to understand. The calculation of value added in every stage is not an easy task.

3. To implement the VAT successfully, customers, need to be conscious, otherwise tax evasion will be widespread.

4. VAT is too difficult to operate from the position of both the administration and business

Source: IMF, 2015

Importance of Introducing VAT in KSA

- Government to become more accountable (by virtue of having more tax revenues to finance the budget).

- Public perception of government to improve (by virtue of leaving more oil revenues for future generations).

- GOV. income diversification.

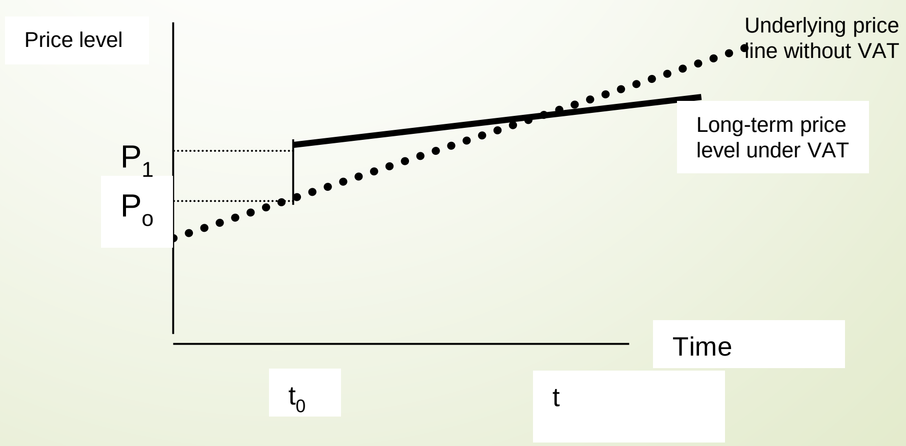
- Applying such a measure will bring the country to the international standards by meeting government finance statistics classification requirements (2014 GFS Model).

Source: IMF, 2015

VAT and Inflation

- Concern about VAT-induced inflation unfounded.
- Probably one-time price rise when VAT introduced.
- Even VAT non-inflationary or deflationary, critical in good timing for introducing VAT in order to avoid social tension and fear in the public.

Impact of the VAT on general price level



Source: IMF, 2015

Reasons for Low Tax Revenues in GCC

1. Absence of personal income tax;
2. Absence of property tax in most of the GCC;
3. Absence of customs duties on GCC products;
4. Grant of tax holidays in different industrial zones;
5. Reduction in effective tax rates on foreign corporations.

These benefits were given in order to promote direct investment, and attract expatriates to help build up infrastructure and accelerate broader economic activity.

Source: IMF, 2015

VAT and Monetary Policy

- If the VAT is revenue-enhancing, it will help the government pursue tight monetary policy, and then the VAT may even exert downward pressure on inflation—in this case, the VAT is **deflationary** rather than inflationary.

Source: IMF, 2015

The Implementation Process in KSA

(based on international experience)

- Components requiring TA must be determined early
- Steering Committee & VAT Administration Unit should be named without further delay!
- Move swiftly to define the major policy issues in order to develop a "white paper" as the basis for public dialogue.
- Realistic timetable for VAT policy decisions and administrative programs will be essential.
- The most effective standard planning period for the implementation of a VAT, is projected to be at least over a 18-months period (International experience suggests that it takes 18–24 months from the time that a decision is made for implementation).
- Bring the private sector to the table (significant role)
- Publicity and education program through couple ***phases:***
  - Presentations (lectures/talks/town hall meetings) targeting various economic business sectors and civil society.
  - Media presentations through speeches & discussion forums
  - Production of technical and procedural manuals

Source: IMF, 2015

Who Should Run the Show?
Global Practice

- MOF
- Revenue Collection Authority/Unit
  - Independent from other revenue measures collections!

Source: IMF, 2015

Requirements for Administering a Successful VAT

- Facilitation of taxpayers to fulfill their obligation easily—filing returns, paying tax, easy and quick access to legislation, and technical and administrative interpretation and information.
- Integrated IT systems to support a robust compliance program including timely detection of non-filers and stop-filers and identification of receivables for enforcement collection.
- The administrative system for the VAT should be fully technology driven.
- A risk-based audit selection system.
- Comprehensive audit programs and effective supervision of auditors.
- Transformation of the mind-set of auditors towards adopting new approaches to auditing VAT taxpayers.
- TONS of *points of sale.*
- A unique ***TIN*** used by all revenue agencies including Customs is an important prerequisite for effective VAT administration (tax administration facilitates information-sharing)

no TIN is assigned to more than one taxpayer

Source: IMF & WB, 2015

Cont.

- The success of a VAT is heavily reliant on the exchange of information between revenue and other government agencies.
- Establishment of a registration system.
- Staffing & Recruitment & Training.
- Limiting the scope of exemptions at the beginning.
- Prepare manuals covering all operational areas to become the desk file

Source: IMF, 2015

Characteristics of a Successful Functional Structure in Tax Administration

- **A strong HQ organization, which is responsible for:**
  - ✓ Preparing an annual national work plan;
  - ✓ Monitoring and reporting on performance against the work plan through the year;
  - ✓ Designing and maintaining standardized processes and policies; and
  - ✓ Providing advice and guidance to operational units.

- **A distinct organization for field operations and delivery, structured across all taxes into:**
  - ✓ audit and investigations;
  - ✓ collections and enforcement; and
  - ✓ registration and taxpayer services—including returns and payments processing.

Source: IMF, 2015

Proposed Structure of the VAT law

Preliminaries	Title and contents (self explanatory)
Chapter 1	Imposition of the VAT – provisions that actually impose the VAT, the rate and the date of commencement; use of defined terms; relationship to other laws (e.g. customs).
Chapter 2	Core provisions of the VAT : ➢ When and how the tax arises, who is liable to pay it (e.g. supply, consideration, taxable supplies, taxable importation taxable person, registration thresholds and requirements, place and time of supply, ➢ When and how input tax credits arise and entitlement to them. ➢ Accounting for VAT – e.g. payment and refund timing, net amounts, returns, adjustments, calculations and procedures, tax periods, due dates, self-assessment, etc.
Chapter 3	Exemptions and zero-rated supplies
Chapter 4	Special rules – second-hand goods, margin schemes, free zones, agents, financial supplies, changes to original purpose, reverse-charging,
Chapter 5	Compliance – taxpayer rights and obligations, invoices, price display, record-keeping, penalties and interest, fraud and evasion, anti-avoidance, objections and appeals.
Chapter 6	Transitional arrangements – contracts.
Appendices	Dictionary of defined terms, any detailed definition of exemptions (e.g. "basic" food; medicines)

Source: IMF, 2015

VAT Pricing Options

- Some countries require the VAT content of a price to be shown clearly and separately from the tax-free price so that the buyer is fully aware of his tax liability.
- Others claim that buyers want to know the full cost of a good including tax and do not wish to be faced with an additional fee at the retail point.

Example:

- $99.00, or
- $99.00 (including VAT), or
- $90.00 + $9.00 = $99.00, or
- $90.00 + $9.00 (VAT) = $99.00

Source: IMF, 2015

The VAT in GCC

- Agreement on a common GCC VAT law framework;
- Each GCC country to have its own VAT law formulated in line with common GCC VAT framework;
- VAT law to be implemented simultaneously in all GCC countries. Timetable yet to be decided.
- The initial VAT rate to be set at less or equal to 5%.
- Negotiations to reach an agreement on some common tax exemptions.

Source: IMF, 2015

Cont.

- If designed well, it could generate GCC countries additional revenues in the range of 1.5 - 2 percent of GDP or 2.5 - 3.5 percent of non-oil GDP even with relatively low rates;

- IMF has estimated that Saudi Arabia could generate additional tax revenue in the range of 1 - 1.6 percent of GDP based on a VAT rate set in the range of 3 - 5 percent.

- IMF has already provided technical assistance for the design of a VAT in the region, both regionally and to national governments since the late 1990s.

Source: IMF, 2015

Extent of GCC Governments' Dependence on Oil Revenues

Figures based on 2012-14 Data

	Total Revenues	Total GDP	Non-oil GDP
Oil revenues (as % of):	79.8	37.4	77.0
Non-oil revenues (as % of):	20.2	9.4	18.4
Investment income on public assets	16.8	7.8	15.3
Tax revenues	3.4	1.6	3.1

Source: IMF, 2015

GCC Countries: Revenue Structure (2012–14)

	2012	2013	2014	2012-14
	In percent of GDP			
Total Revenue	48.9	47.6	44.0	46.8
Non-Oil Revenue 1/	8.6	9.6	9.9	9.4
o/w Tax Revenue	1.6	1.5	1.7	1.6
Oil Revenue	40.3	38.0	34.1	37.5
	In percent of non-oil GDP			
Total Revenue	106.1	96.8	83.2	95.3
Non-Oil Revenue 1/	17.9	18.8	18.2	18.3
o/w Tax Revenue	3.3	2.9	3.0	3.1
Oil Revenue	88.2	77.9	65.0	77.0
	In percent of total revenue			
Non-Oil Revenue 1/	17.5	20.2	22.5	20.1
o/w Tax Revenue	3.3	3.2	3.8	3.4
Oil Revenue	82.4	79.8	77.5	79.9

1/ includes investment income

Source: IMF, 2015

Breakdown of Tax Revenue in GCC

GCC Countries: Breakdown of Tax Revenue
(In percent of GDP)

	Total	Income	Goods & Services	Corporate	Trade	Property	Other
Bahrain	0.6	...	...	...	0.6	0.3	-0.3
Kuwait	0.8	...	...	...	0.6	0.03	0.2
Oman	2.8	...	...	1.4	0.7	...	0.6
Qatar	1.7	...	...	1.3	0.4	...	0.0
Saudi Arabia	1.4	...	...	0.0	0.9	...	0.5
UAE	2.5	...	...	1.0	0.7	...	0.7

Source: IMF estimates

Note: Latest data is for 2014 where available; Qatar total revenue is for 2013; Kuwait trade tax data is for 2012; Bahrain and Kuwait property tax data are for 2004 and 2012, respectively; Other taxes calculated as residual

Source: IMF, 2015

Saudi Arabia Components of Tax Revenues in 2014

Trade tax	=	0.9% of GDP
Corporate tax	=	0.0% of GDP
Income tax	=	0.0% of GDP
Goods/Services tax	=	0.0% of GDP
Other tax	=	0.5% of GDP
Tax revenue	=	1.4% of GDP (very low)

Source: IMF & SAMA, 2015

Estimation of VAT Revenue in KSA

GCC Countries: Estimated VAT Revenue

		Using average C-efficiency ratio (0.58) of selected sample of countries with experience relevant to the GCC			Assuming the base = 90 percent of private consumption		
			Revenue at a VAT rate of			Revenue at a VAT rate of	
	Year	Share of final consumption in GDP	3%	5%	Share of private consumption in GDP	3%	5%
Bahrain	2014	56.6	*0.9*	*1.6*	41.0	1.1	1.8
Kuwait	2014	50.2	0.8	1.4	31.2	0.8	1.4
Oman	2014	51.6	0.9	1.4	24.8	0.7	1.1
Qatar	2014	29.6	*0.5*	0.8	15.1	*0.4*	*0.7*
Saudi Arabia	2014	58.9	1.0	1.6	32.5	0.9	1.5
UAE	2014	55.3	0.9	*1.5*	47.7	*1.3*	*2.1*

Source: IMF staff calculations

Source: IMF, 2015

Key Implementation Tasks

Implementation Task
0. Preparation of project plan; mobilization of funds
1. VAT law and secondary legislation (rules and regulations)
2. VAT administration programs and business processes
3. Staff communication, engagement, and change management
4. VAT organization structure and staffing arrangements
5. Staff recruitment
6. Staff training
7. COTS system
8. Data Center, Processing Center, Contact Center
9. Desktop hardware and software; servers; data network
10. Taxpayer education
11. Accommodations for field offices and project team
12. Customs administration program for

Source: IMF, 2015

Preparatory Timetable for Introduction VAT

Stage 1	**Preparatory Work for the VAT** Step 1: Establish a committee to prepare for the VAT. The committee would be chaired by the secretary general for taxation, and would comprise representatives from other concerned agencies and departments. Step 2: Review and decide on policy aspects of the VAT. Step 3: Produce a report for the ministers, and seek its approval.
Stage 2	**Drafting of VAT Law and Regulations** Step 4: Commence drafting of VAT law and any necessary changes to other laws. Step 5: Ensure the enactment of the draft. • Review by Council of Ministers. • Consultation with business community. • Final law revisions before submitting for approval/legislation. Step 6: Produce regulations and implementation circulars.
Stage 3	**Development of VAT procedures** Step 7: Operations • Review and complete TINs to be used by customs and tax departments. • Define procedures for registration. • Define procedures for submitting VAT returns and making payments. Step 8: Forms • Design and print forms for registration, tax returns, and payments. Step 9: Computerization • Specify hardware and systems requirements. • Purchase and install equipment. • Develop and test software for assigning TINs. • Commence registration of enterprises. • Develop ways of monitoring delinquent taxpayers. • Develop accounting and statistical data. • Develop automated audit selection criteria. Step 10: Information • Conduct briefing seminars for ministry and tax department staff. • Prepare VAT information guides and manuals. Step 11: Publicity Step 12: Professional training
Stage 4	**Entry into force of VAT law**

Source: IMF, 2015

Appendix

جدول 1: الايرادات غير البترولية الفعلية والمتوقعة بنهاية العام المالي الحالي 1437/1436هـ (2015م)
مقارنة بالعام المالي السـابق 1436/1435هـ (2014م)

عنصر الإيراد	الإيرادات الفعلية والمتوقعة لعام 1437/1436هـ (مليون ريال)	الإيرادات الفعلية لعام 1436/1435هـ (مليون ريال)	نسبة التغير %
رسوم المنتجات البترولية	16.080	15.041	6.91
الرسوم الجمركية	25.000	23.520	6.29
رسوم وأجور الخدمات العامة	1.800	1.611	11.73
حصة الحكومة من قطاع الاتصالات	4.400	4.962	(11.33)
الأوراق ذات القيمة[1]	15.700	14.531	8.04
ضرائب الدخل الأخرى	14.000	13.925	0.54
الإيجارات والمبيعات	1.800	1.146	57.07
الاستثمار	37.000	21.858	81
الإيرادات المتنوعة	25.500	9.230	149
الزكاة[2]	14.500	14.299	1.41
رسوم وأجور خدمات الموانئ	4.000	3.762	6.33
رسوم التأشيرات	2.700	2.394	12.78
المقابل المالي للتعدين	520	517	0.58
الإجمالي	163.500	126.796	36.83

Source: MOF, Saudi Arabia, 2015